



## Foreign Direct Investment and Competition Policy

Recent years, especially prior to September 11, 2001 have experienced a very rapid increase in FDI with an increasing share of it coming through merger or acquisition of existing firms in the host country. On the other hand, many countries have recently adopted a competition law with most of the laws containing merger control provisions. This means that much more FDI now has to undergo the scrutiny of competition authorities. Thus, increasingly, FDI related competition issues are becoming more important. FDI has also become an important way for companies to supply to foreign markets. Indeed, the WTO General Agreement on Trade in Services (GATS) considers the supply of services through commercial presence of a foreign supplier as a form of trade. Similarly, the WTO agreement on Trade Related Investment Measures (TRIMs) has also liberalised the investment environment.

### Background

A synergy exists between investment liberalisation and the effective application of competition policy. An effective competition policy does not only remove obstacles to entry, but can also facilitate foreign investment flows by providing a predictable legal and regulatory environment that reduces the scope of arbitrary decision-making. Regulation of the business practices of investors through competition law is less restrictive and distortive than other policy instruments can be.

On the other hand, FDI can serve to increase competition in local markets, particularly in investments of the greenfield type. The takeover and rejuvenation of local enterprises can also have such effects.

However, there is a possibility that over time such takeovers may make the markets increasingly concentrated and become characterised by one or a small number of dominant players.<sup>1</sup> Mehta and Nanda (2003) cite the takeover of a well-established brand Indian cola drink, Thums Up, by Coca Cola in India as one example of such a phenomenon, which they argue, came at a very high cost in terms of a substantial lessening of competition in the market.<sup>2</sup>

This suggests that proper application of competition policy or law can be vital for ensuring that the potential benefits of FDI for a host country are maximised.

From a narrow national market perspective, a cross-border acquisition may seem to have no effect on competition. But if the acquirer has been a major exporter to the country, then the acquisition may lead to lessening of effective competition in the market. Such acquisitions may be aimed at regional or global consolidation by the transnational corporations (TNCs) concerned.

These issues will be discussed below in more detail with examples from the 7Up Project, which was a comparative study of competition regimes in seven developing countries. It was a two-year project implemented by Consumer Unity & Trust Society (CUTS), Jaipur, India and supported by the Department for International Development (DFID), UK. It has been very successful in raising awareness and stimulating debate on these issues and facilitating reforms in the project countries and beyond.

### FDI and Competition

The cola soft drink case in India has an interesting history and shows how absence of an appropriate competition law may lead to a situation that fails to bring the best outcome from FDI. In 1977, in a political climate less friendly to FDI than the present, Coca Cola was forced to leave India after it refused to:

- disclose its formula, as required by the Indian food safety law; and
- dilute its equity stake in its Indian subsidiary to 40 percent.<sup>3</sup>

Pepsi Cola did not operate in India those days. Following the departure of Coca Cola, Indian entrepreneurs developed local cola drinks: 'Thums Up,' 'Double-7' and 'Campa Cola,' and also drinks in the orange and lemon flavoured sectors. Parle's Thums Up was the most successful brand and it cornered the lion's share in the market along with its other products like 'Gold Spot' (orange-flavour) and 'Limca' (lemon-flavour).

In 1986, Pepsi Cola was allowed to set up shop in India with export obligations for processed foods. Pepsi Cola found it difficult to penetrate the market initially, because of the large share of the soft drink market held by Parle, but it gradually succeeded in penetrating the market and raising its market share. However, Parle continued to dominate the market. Further, Parle's brands were also exported to countries in South and Southeast Asia, Africa and Middle East.

Following economic reforms in the 1990s, Coca Cola was allowed to return to India. It decided to buy out the three successful brands of Parle's rather than compete against them. As a result, there are now effectively only two competitors in India's domestic and export markets: Pepsi and Coca Cola. There being no merger and acquisition (M&A) provisions in the existing competition law, there was no possibility of challenge.

While high market concentration does not necessarily imply a lack of competition or contestability, high concentration and a large market share may make it easier for firms to undertake anticompetitive practices (UNCTAD 1997)<sup>4</sup>, especially where entry barriers exist through brand dominance; intensive and extensive advertising; high investments; control over distribution systems etc. Where this happens, the lack of competition law, or of merger review provisions in competition law, can reduce the investor-friendliness of the environment by allowing concentration to rise. It may also make it more difficult for domestic entrepreneurs in developing countries to succeed.

The case of the cement industry in India on the other hand, demonstrates that FDI can also be good for competition. Some major international players, such as Lafarge, Italcementi and Cemex have made their foray into Indian market through the M&A route which has *prima facie*, reduced the potential for any collusive practices in this sector. Thus, it is believed that the entry of the foreign players has augured well for competition in the cement market, at least for the time being, as it has reduced the potential for any

anticompetitive practices that may have previously taken place or could take place even now.

In the case of cement industry, the FDI entered through M&A route, which means that the enhanced competition occurred not because there were more competitors now, but because the foreign players were not willing to play the ball with the domestic competitors who have been cartelised. It is, therefore, natural to think that FDI will be even better for competition, if it entered with greenfield investment. Indeed, this has been the case in car industry in several countries including India, South Africa and Brazil where foreign car manufacturers came with new plants. This led to availability of better cars at competitive prices.

### **Competition Policy Facilitating FDI**

In the past few years, the cement industry has seen much M&A activities and consolidation all over the globe. The French multinational Lafarge has been particularly active. In recent years, it has expanded into southern and eastern Africa by acquiring many local firms and hence has become a dominant market power in the regional market.<sup>5</sup>

The 2001 merger between Lafarge and Blue Circle PLC had implications for the Southern and Eastern African regional market. In December 2000, it was announced that a joint venture of Blue Circle PLC and Lafarge S.A. would acquire the Pan African Cement (PAC) Company, a wholly owned subsidiary of the Commonwealth Development Corporation (CDC).

However, with the international merger between Lafarge and Blue Circle, the acquisition plan was changed and PAC was to be taken over by Lafarge only. PAC till then held controlling interest in cement manufacturers in three countries: Malawi (Portland Cement), Tanzania (Mbeya Cement) and Zambia (Chilanga Cement). Prior to this deal, Lafarge had no presence in any of these countries, therefore on the face of it the deal did not change the structure of the market in any of these countries. However, for the regional market, the deals, in combination with the merger of Lafarge and Blue Circle PLC raised serious competition concerns.<sup>6</sup>

The effect of the proposed takeover in Zambia did not raise any competition concerns *per se*. This was so because the move did not raise the current concentration levels in the cement industry in Zambia i.e. it did not result in the reduction of the number of players, especially the removal of an aggressive competitor from the market. Secondly, the move did

not raise Lafarge's current market share position to a higher one and of dominance.

However, competition concerns in the regional market and non-existence of an effective competition law in other countries of the region prompted Zambia Competition Commission (ZCC) to take a closer look at the case and examine it from different perspectives.<sup>7</sup>

Moreover, in Zambia, the Chilanga Cement case became a national issue for several reasons. It had been argued that the Chilanga cement plants were known to be in obsolete state, and the proposed acquirer, Lafarge, had the capability and the likely global economic rationale to source cement and supply the Zambian market from outside. Thus, the logical step for Lafarge would be to shut down the plants in Zambia. Indeed, they were likely to have been shut down in due course in any case. However, the socio-economic costs of shutting down the Chilanga Plants were perceived to be high.

In light of the public opposition to the closure of the plants, it would have been extremely difficult for the Zambian Government to allow this takeover. Thus the ZCC only allowed the takeover with some conditions attached. Among others, Lafarge agreed to maintain and improve production at Ndola works from 60 to excess of 80 percent capacity utilisation within two years and that it would not take any decision that would have the overall effect of reducing the production of cement in Zambia.

Thus the intervention of the ZCC ensured the future of cement production in Zambia by facilitating the entry of Lafarge, both of which would have been difficult otherwise. The only cement company in the country was faced with a threat of closure with or without a takeover by Lafarge. However, the action taken by ZCC could remove such a threat. This demonstrates how appropriate intervention by a competition authority can maximise the benefits from FDI to a host country.

### **Dismantling Entry Barriers**

An investor-friendly environment requires that entry barriers be minimised. This helps foreign and domestic investors equally. Thus, by dismantling entry barriers and providing a stable and predictable legal-economic environment for investors, a well-defined competition policy and law can help to create a sound economic environment that attracts foreign direct investment (FDI) can play a significant role in promoting investment.

However, in most developing countries, where competition law is often non-existent or ineffective, such entry barriers persist. A properly implemented competition law can also help to ensure FDI is development-friendly, and that the benefits are maximised for host countries.

In the case of acquisition by Nestle of pet products from its joint owners, Heinz SA and Tiger Foods in South Africa, the Competition Commission had recommended that the merger be approved. The Competition Tribunal, however, found that the costs of developing branded products in order to get supermarket distribution were a "huge" barrier to entry. Therefore, it recommended only conditional approval of the merger, subject to the divestiture of two pet products brands, Dogmor and Catmor.<sup>8</sup>

Similarly, in the Nampak/Malbak merger that involved two of the country's largest packaging firms, the resulting entry barriers were considered to be high. The merged firm was required to sell to a third party the machineries necessary to manufacture the relevant products.<sup>9</sup>

The restrictive distribution system in Japan had long been considered as a huge entry barrier for foreign business and products as well as potential domestic entrants. Most competition laws have provisions for dealing with such exclusionary practices foreclosing markets to new entrants. However, in most developing countries, enforcement of competition law is rather weak as it has been in Japan, particularly in the context of vertical restraints.<sup>10</sup>

In a recent judgement, the Indian competition authority, the Monopolies & Restrictive Trade Practices Commission, directed Titan Industries Ltd., the Indian watch-manufacturing giant to remove exclusive dealing clauses from its franchisee/dealership agreements, thus allowing the franchisees/dealers to sell products of other companies.<sup>11</sup>

In network-based service industries like telecommunications, where the existing players are allowed to refuse access to existing network this can serve to block the entry of any new players. For example, in Bangladesh, despite the fact that private mobile operators play a major role in providing connectivity, especially in rural areas, the majority of mobile subscribers do not have access to the fixed lines provided by the state-owned telecom company.<sup>12</sup>

This has significantly affected the growth of private sector telecom operators. This might have significantly

affected the entry of FDI in the telecom sector of the country as well. In India, however, such interconnectivity was made mandatory by the telecom regulator. Thus, the telecom sector in India has seen phenomenal growth in recent years with both domestic and foreign investors coming in.

## Conclusion

The proper implementation of competition policy can play an important role in promoting an open and competitive environment for both domestic and foreign enterprises. In most developing countries, there are regulatory and legal barriers as well as anticompetitive practices of existing firms (in some cases), which can effectively impede or make the entry of new domestic or foreign firms very difficult and costly. In this context, an empowered competition agency can play a significant role not only by removing the anticompetitive practices that act as entry barriers, but also by advising the government on related policy issues to remove other types of entry barrier and thereby facilitating more investment in the economy. Competition and efficiency in public utilities and sectors of

intermediate goods play an important role in promoting investment.

However, competition authorities need to ensure a transparent, fair and rapid process while investigating, prosecuting and adjudicating anticompetitive practices or reviewing M&As. The failure to do so may be counter-productive and, in fact, may discourage investment, both domestic and foreign. To sum up, a well-designed competition policy can promote development-friendly investment by:

- providing a stable and predictable legal-economic environment for investors;
- dismantling entry-barriers created through private anticompetitive practices;
- advising government on other policy issues that have a bearing on entry-barriers;
- providing cheaper utilities and raw materials by promoting competition and efficiency in those sectors;
- preventing too high a level of concentration in particular markets; and
- facilitating FDI in a way that is in the interests of, and maximises the benefits to, the host country.

---

## Endnotes

- 1 See Pradeep S Mehta and Nitya Nanda, "Competition Issues With International Dimensions" in CUTS (ed), *Competition Policy & Pro-poor Development*, CUTS, India, 2003, pp41-56.
- 2 Ibid, p46.
- 3 Frontline, Volume 20, Issue 19, September 13-16, 2003.
- 4 UNCTAD (1997) World Investment Report 1997: Transnational Corporations, Market Structure and Competition Policy, New York: United Nations
- 5 See CUTS, *Pulling Up Our Socks – A Study of Competition Regimes of Seven Developing Countries of Africa and Asia: The 7Up Project*, CUTS, India, 2003, p65.
- 6 See Zambia Competition Commission, *Final Report on the Proposed Takeover of Chilanga Cement PLC By Lafarge S.A Of France*, Zambia Competition Commission, Lusaka, 2001.
- 7 Ibid.
- 8 For details see [www.compcom.co.za](http://www.compcom.co.za)
- 9 Ibid
- 10 Hiroko Yamane and Shingo Seryo, "Restrictive Practices and Market Access in Japan – Has the JFTC Been Effective in Eliminating Barriers in Distribution?" *World Competition*, Vol. 22, No. 2, 1999.
- 11 "MRTPC Directive to Titan Industries", *The Hindu Business Line*, New Delhi, June 09, 2001.
- 12 CUTS, *Approaches to Competition Policy in South Asian Countries*, CUTS, India, 2003, 13.

---

© CUTS, 2005. This Briefing Paper is produced by CUTS-C-CIER to inform, educate and provoke debate on investment and competition policy issues. Readers are encouraged to quote or reproduce materials from this paper for their own use, but CUTS requests due acknowledgement and a copy of the publication. The paper draws heavily from the experience/output of the "7Up Project" that involved a comparative study of competition regimes in seven developing countries. The Project was implemented by CUTS during 2000-2002 in partnership with local institutions in selected counties: India, Kenya, Pakistan, Sri Lanka, South Africa, Tanzania and Zambia, and with the support from Department for International Development (DFID), UK.

---

This Briefing Paper is written by Pradeep S Mehta and Nitya Nanda of and for CUTS Centre for Competition, Investment & Economic Regulation (CUTS-C-CIER), D-217, Bhaskar Marg, Bani Park, Jaipur 302 016, India. Ph: 91.141.228 2821, Fx: 91.141.228 2485, E-mail: [c-cier@cuts.org](mailto:c-cier@cuts.org), Web Site: [www.cuts-international.org](http://www.cuts-international.org). Printed by Jaipur Printers Pvt. Ltd., M. I. Road, Jaipur 302 001, India.

---